

The purpose of this report is to keep policy makers apprised of changes in the national and local economies that the Montgomery County Department of Finance believes may impact current and/or future revenues and expenditures.



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For questions regarding this report, please contact:

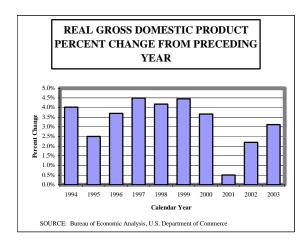
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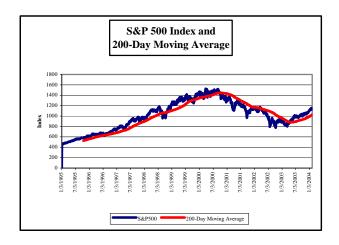
ECONOMIC OVERVIEW

The economic recovery that began during the fourth quarter of 2001 continued to gather momentum during 2003 while inflation continued to remain subdued. The year began with uncertainties about the geopolitical environment, particularly the impending war in Iraq. However, because of the stimulus of fiscal and monetary policies created by the income tax cuts and the accommodative monetary policy by the Reserve (Fed), the economy Federal accelerated during the second half of 2003. Based on revised data, real gross domestic product increased 3.1 percent. That increase was the largest since 2000 (+3.7%).



The dramatic growth in the economy during 2003 was attributed to consumer spending (+3.1%), investment in information processing and equipment (+13.7%), and residential real estate (+7.6%). Real consumer expenditures for durable goods surged 7.4 percent during 2003, the largest increase since 1998, while purchases of nondurable goods increased at a moderate pace of 3.7 percent.

The stock market also had a tremendous year with four of the market indices experiencing significant growth through most of the year. The Dow Jones Industrial Average was up 25.3%, the broader S&P 500 index was up 26.4%, and the NASDAQ and Russell 2000 indices, representing technology and small capitalization stocks, were up 50.0% and 41.9%, respectively.

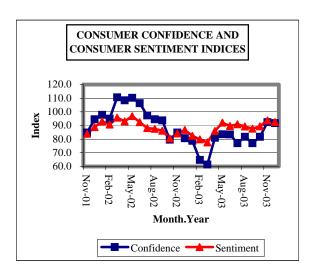


Short-term interest rates continued to remain at 45-year lows and interest rates on 30-year fixed rate mortgages ended the year at 5.81 percent, slightly below the rate at the end of 2002 (5.93%). The Fed's target rate of 1 percent for federal funds is expected to remain at that level through the first half of 2004, thereby keeping interest rates on money market funds at historic lows.

Because of low mortgage rates, the real estate market continued to be the success story of 2003, particularly during the second half. In the final month of 2003, housing starts ended the year at an annual rate of 2.1 million units, an increase of 15.0 percent over December 2002 and the largest one month gain since February 1984 (2.3 millions units). Housing sales increased an estimated 9.1 percent in 2003, the largest increase since 1998 (13.4%).

While the economy continued to expand, the stock market rebounded significantly, and the housing market continued to show strength during 2003, consumer confidence

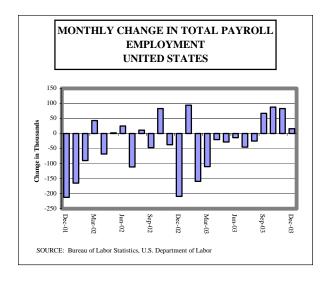
remained pessimistic during most of 2003. Consumer attitudes remained bearish on the economy particularly during the first three quarters of 2003 when the Conference Board's index declined almost 25 percent compared to the first three quarters of 2002, and University of Michigan's sentiment index decreased 5.8 percent over the same However, consumers period. turned increasingly optimistic during the last quarter of the year. The confidence index increased 14.6 percent during the October-December timeframe compared to the same period last year and the sentiment index increased 15.3 percent during the threemonth period.



The pessimism among consumers during most of 2003 was attributed to an abysmal labor market. Total payroll employment was less than 130 million in 2003, which was the first time since 1999 that total employment was below that threshold. Since the end of the recession in November 2001, the national economy lost almost 1.2 million jobs. That is the first time that jobs were lost during the first 24 months of any recent economic recovery and expansion period. During 2003, the economy lost over 50,000 jobs mostly during the first half of

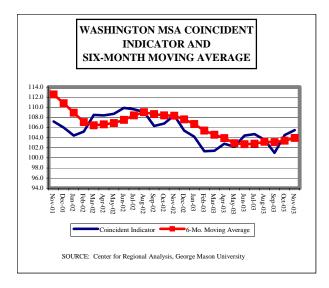
the year with all of the cuts occurring in the public or government sector.

The modest upturn in private payroll employment particularly during the last four months of 2003 was attributed to an increase in hiring in the private service sector. According to the Fed's Monetary Policy Report to the Congress, hiring at businesses that supply professional, business, education, and medical services continued to add jobs. Employment in both the construction industry, attributed to the healthy residential real estate market, also increased.



It is against the national economic backdrop that the economic performance of the Washington metropolitan statistical area (region) and Montgomery County is analyzed. According to the Center for Regional Analysis (CRA), the region's economy rebounded in June after a sluggish performance the previous twelve months.

The Washington Coincident Index, a measure of the current state of the region's economy, increased in November. That increase of 1.0 percent follows an October increase of 3.5 percent, the largest monthly increase since March 2002.



Of the four components that comprise the coincident index, three were positive: wage and salary employment (+0.3%), consumer confidence (+11.2%), and domestic passenger volume at Reagan National and Dulles International Airports (+0.5%). Purchases of nondurable goods, on a seasonally adjusted basis, declined 1.1 percent following a 3.1 percent increase in October.

The current strength of the region's economy is the labor market. While the payroll survey and the household survey provide slightly different trends, both suggest improvement in the employment situation over the past three to four months. The payroll survey reported a gain of 38,500 new jobs in December over December 2002 (+1.4%), while the household survey indicated an increase of 42,000 net new resident workers in December compared to December 2002 and the unemployment rate declined from 3.2 percent in December 2002 to 3.0 percent in December 2003.

According to CRA, the sector that accounted for the largest increase in private-sector employment during the December

2002-2003 period was professional and business services. Other sectors that gained employment included education and health services, retail trade, leisure and hospitality, construction, and financial services.

Consumer spending in the region followed the national trend with purchases of durable goods outpacing nondurable goods. With employment rebounding and consumer confidence increasing during the final quarter of 2003, such trends are reflected in the sales of durable goods. In November, sales, on a seasonally adjusted basis, increased 5.8 percent over October and 10.8 percent over November 2002.

However, while employment, consumer confidence, and retail sales showed improvement during the late fall of 2003, the housing market began to soften with building permits declining in November from October (largely attributed to seasonal factors) but also from November 2002. Such declines may be attributed to a slight increase in the mortgage rates during the fall and also to a slowdown in the momentum in housing construction over the past year.

While the region's economy showed improvement during 2003 especially the final quarter of 2003, Montgomery County's economy experienced mixed results during 2003. Highlights of the County's economic performance include:

• Retail sales as measured by sales tax receipts increased 3.7 percent in November and 3.8 for the first eleven months of 2003.

- Inflation continued to remain subdued with the overall rate at 2.4 percent in November and 2.9 percent for the year.
- The County's unemployment rate continues to be the lowest in the State and at 2.3 percent in December was below the region's (3.0%) and the State's (4.1%).
- Construction, both residential and non-residential, experienced declines in the rate of additional capacity during 2003. Office vacancy rate for Class A property remained at an alltime high.
- Housing sales were moderate but average prices continued their dramatic increase.

MONTGOMERY COUNTY ECONOMIC INDICATORS

Retail Sales

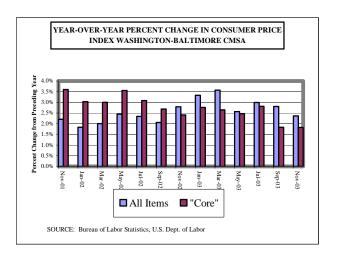
Retail sales increased 3.7 percent in November compared to the same month in 2002. For the first eleven months of 2003, sales in the County increased 3.8 percent compared to a meager 0.9 percent during the same period in 2002. Sales in 2003 matched the rate in 2001 (+3.8%) but were below the levels in 1999 (+6.1%) and 2000 (+6.6%).

The growth is sales in 2003 was attributed to both to an improvement in the purchases of nondurable and durables goods. Sales of durable goods increased 3.2 percent during the first eleven months of 2003

compared to a meager 0.8 percent for the entire 2002. Purchases of nondurable goods increased 5.0 percent compared to 1.7 percent in 2002.

Inflation

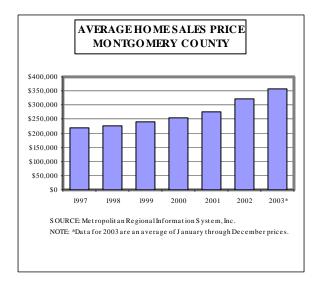
Inflation as measured by the Consumer Price index remained subdued during 2003. Since January, the overall inflation rate was 2.9 percent compared to 2.4 percent for 2002 and 2.3 percent for the nation. The slight increase in inflation is attributed to increases in rent (+5.2%), utilities (+5.8%), gasoline (+16.0%), and medical care (+3.1%). The "core" rate of inflation, consumer items not including food and energy goods, was 2.4 percent, which was lower than the rate in 2002, but significantly above the national rate of 1.4 percent.



Residential Real Estate

The housing market in Montgomery County remained the economic story of 2003. Average prices continued their meteoric rise during the year reaching a December average of slightly over \$400,000. For the year, average prices

increased 12.0 percent. Since 1997, prices of homes in the County increased almost 64 percent or an average annual rate of 8.2 percent.

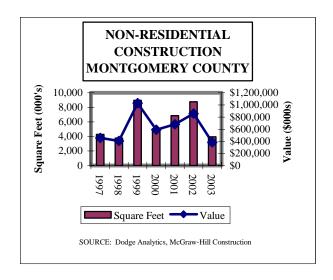


While average prices continued their exponential increase, the increase in the sales of homes was only 2.3 percent in 2003 compared to 5.2 percent in 2001 and 3.1 percent in 2002. While the prices of homes increased dramatically during the 2001-2003 period, the average sales rate (+3.5%) was significantly lower compared to 1998-1999 period (+17.6%). The decline in the rate of sales accompanied by the dramatic increase in prices suggests that the stock of available housing in the County is insufficient to meet demand.

Construction

Construction activity in the County during 2003 experienced significant declines in the amount and value of additional capacity. The decline in the number of building permits for non-residential property suggests that the amount of additional capacity declined in 2003 and will continue

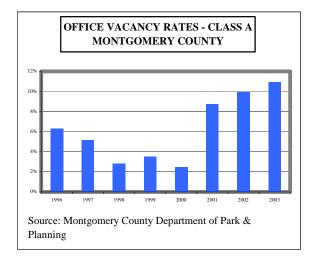
to decline in 2004. The number of non-residential permits issued in 2003 was 1,798 which were 3.2 percent lower than the 1,858 issued in 2002.



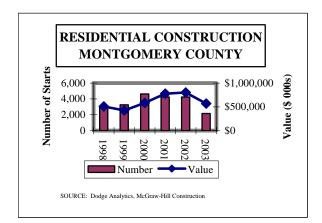
The amount and value of construction of non-residential property in 2003 was the lowest since 1998. Less than 4 million square feet was added to the County's nonresidential property in 2003, a decline of 54.8 percent over the previous year's nearly 8.8 million square feet. The decline in the rate of additional square footage was matched by the decrease in the value of new construction added to the County's commercial real estate. With only \$382 million of additional commercial property constructed in 2003, it was the lowest since 1995 when only \$352 million was added.

The decline in the rate of additional non-residential property is attributed to the dramatic increase in the vacancy rate for Class A in the County. Since 2000, the rate increased dramatically from 2.4 percent to 10.9 percent as of December, a fourfold increase. The rise in the vacancy rate between 2000 and 2002 matches the increase in new non-residential construction.

With the drop in added capacity in 2003, the imbalance between supply and demand should diminish along with the vacancy rate.



The amount of residential construction also declined in 2003. The number of new single-family units built in 2003 was slightly less than 2,100 compared to almost 4,200 units in 2002, a decline of 50 percent. The number of new units in 2003 was well below the 2000-2002 average of 4,250 and the lowest since 1997. With the significant drop in housing construction, the value of additional residential property also declined dramatically to its lowest level since 1999.



The decline in the value of additional residential and non-residential property will affect the growth in the real property assessable tax base for Montgomery County. To date both reassessments and new construction have added approximately 8.2 percent to the assessable base. With the drop in the value of new construction, appreciation of the assessable base will mostly come from reassessments.

Employment

Average resident employment reached 495,000 in 2003, an increase of 1.1 percent for the year, but half the 2.3 percent increase in 2002. The labor force in the County continued to grow reaching an average for the year of approximately 508,000. The unemployment rate averaged 2.5 percent for the year and was considerably lower than the State's average of 4.3 percent and the national average of 6.0 percent.

While data for payroll employment covers only the first half of 2003, it reached 457,000 in June, which was slightly lower than the 458,000 level experienced in and December of 2002. However, the June 2003 data are significant in two respects. First, they represent the largest monthly increase since September 2001. Second, based on a comparison with the regional payroll employment, the dramatic increase follows a similar pattern experienced in the region, which was followed by a growth of 33,000 (+1.7%)iobs between August and December

Future Economic Performance

CRA's leading index indicates that the region's economic expansion will continue into the first half of 2004. Based on a sixmonth moving average, the index has increased seven out of the past eight months. Short-term interest rates are expected to remain at current levels through the first half of 2004 and mortgage rates are not expected

to increase significantly. Also key to the County's economy is the construction, hospitality, and business service industries. After nearly two years since 9/11, the hotelmotel sector is beginning to recover and with the upcoming Presidential election and inauguration, the industry should expect a solid second half in 2004. With a significant boost in federal procurement, employment should continue to experience gains in the professional and business sectors

SELECTED ECONOMIC INDICATORS	Reporting	Current	Prior Year's	Year To	o-Date	
	Period	Period	Period	2003	2002	2002
Leading Indicators						
National	Dec	0.2%		1.3%		0.7%
Washington MSA Coincident Indicators	Nov	0.4%		0.7%		-0.6%
National	Dec	0.1%		0.4%		0.2%
Washington MSA	Nov	1.0%		-4.2%		-0.7%
Consumer Confidence Index		-				
National South Atlantic Region	Dec	-1.3% 2.8%		-17.7% -14.3%		-14.7% -9.6%
Consumer Sentiment (University of Michigan)	Dec Dec	-4.4%		-14.5% -2.5%		-9.6% -2.4%
Consumer Price Index	Bee	1.170		2.370		2.170
All Items (nsa)						
National	Dec	1.9%		2.3%		1.6%
Washington - Baltimore CMSA Core CPI (nsa)	Nov	2.4%		2.9%		2.4%
National	Dec	0.9%		1.4%		2.4%
Washington - Baltimore CMSA	Nov	1.8%		2.4%		2.9%
Retail Trade						
National (sales - nsa)	Dec	7.8%		5.6%		3.1%
Washington MSA (sales - nsa) Maryland (sales tax)	Nov Nov	4.5% 6.2%		6.1% 3.2%		4.1% 1.6%
Montgomery County (sales tax)	Nov	3.7%		3.8%		0.9%
Employment	1101	3.170		3.070		0.970
National (household data - nsa)	Dec	138,556,000	136,599,000	137,736,000	136,485,000	136,485,000
- Percent Change	_	1.4%		0.9%		-0.3%
Washington PMSA (household data - nsa)	Dec	2,758,987	2,712,003	2,763,091	2,719,777	2,719,777
- Percent Change Montgomery County (resident)	Dec	1.7% 493,625	490.178	1.6% 495,052	489,673	3.7% 489,673
- Percent Change	Бсс	0.7%	470,170	1.1%	402,073	2.5%
Montgomery County (payroll)	June	457,053	453,996	447,891	446,758	449,195
- Percent Change		0.7%		0.3%		0.7%
Unemployment		7.10	7.50	5.004	7.00	7.004
National (nsa) Maryland (nsa)	Dec Dec	5.4% 4.1%	5.7% 4.0%	6.0% 4.3%	5.8% 4.4%	5.8% 4.4%
Washington PMSA	Dec	3.0%	3.2%	3.4%	3.7%	3.7%
Montgomery County	Dec	2.3%	2.3%	2.5%	2.8%	2.8%
Construction						
Construction Starts - Montgomery County	5	ФСС 100	#110. 2 10	#0.40.120	#1 650 106	Φ1 650 106
Total (\$ thousand)	Dec	\$66,198 -39.9%	\$110,218	\$949,138 -42.8%	\$1,659,106	\$1,659,106 9.5%
- Percent Change Residential (\$ thousand)	Dec	\$40,681	\$33,616	\$567,664	\$802,476	\$802,476
- Percent Change	Bee	21.0%	Ψ33,010	-29.3%	φου2,170	-4.2%
Non-Residential (\$ thousand)	Dec	\$25,517	\$76,602	\$381,474	\$856,630	\$856,630
- Percent Change		-66.7%		-55.5%		25.0%
Building Permits (Residential)	N	127 190	124 512	1 714 757	1 502 579	1 747 679
National - Percent Change	Nov	127,189 2.1%	124,513	1,714,757 7.6%	1,593,578	1,747,678 6.8%
Maryland	Nov	1,955	1,954	27,623	26,241	29,293
- Percent Change		0.1%	ŕ	5.3%	,	0.8%
Montgomery County	Nov	315	405	4,467	4,049	5,013
- Percent Change		-22.2%		10.3%		-1.5%
Building Permits (Non-Residential) Montgomery County	Dec	114	145	1,798	1,858	1,858
- Percent Change	Dec	-21.4%	143	-3.2%	1,030	-11.6%
Real Estate		211.70		3.270		1110/0
<u>National</u>						
Sales	Dec	6,470,000	5,940,000	6,100,000	5,600,000	5,566,000
- Percent Change Median Price	Dag	8.9%	\$162,400	8.9%	\$157.667	5.1%
- Percent Change	Dec	\$173,200 6.7%	\$102,400	\$169,517 7.5%	\$157,667	\$158,100 7.0%
Montgomery County		5.770		7.570		7.070
Sales	Dec	1,444	1,349	16,402	16,030	16,030
- Percent Change		7.0%		2.3%		3.1%
Average Price	Dec	\$405,538	\$343,384	\$362,505	\$320,148	\$320,418
- Percent Change Median Price	Dec	18.1%	\$274,000	13.2%	\$255 275	16.5% \$255.275
- Percent Change	Dec	\$325,000 18.6%	φ2/4,000	\$292,067 14.4%	\$255,275	\$255,275 18.7%
Average Days on the Market	Dec	32	28	28	26	25
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METROPOLITAN AREA OFFICE MARKET

Office Vacancy Rate by Jurisdiction and Class, 12/03

Jurisdiction	Class A	Class B	Class C	Total
Loudon	16.62%	10.45%	4.86%	13.85%
Fairfax	14.58%	10.68%	7.58%	13.21%
Frederick	8.33%	10.27%	11.21%	9.39%
Alexandria/Arlington	10.92%	9.46%	4.05%	9.42%
Montgomery	10.92%	9.13%	6.94%	9.83%
District of Columbia	6.23%	5.84%	8.65%	6.35%
Prince George's	12.76%	9.68%	9.87%	11.16%
Metropolitan Area	10.95%	8.50%	7.34%	9.77%

Vacant Office Space Inventory by Jurisdiction and Class (sq.ft.)

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Jurisdiction	Class A	Class B	Class C	Total	
Loudon	962,981	346,045	25,724	1,334,750	
Fairfax	9,714,478	2,996,857	268,187	12,979,522	
Frederick	173,581	169,709	45,863	389,153	
Alexandria/Arlington	2,667,430	1,671,936	283,233	4,622,599	
Montgomery	3,476,892	2,026,705	457,659	5,961,256	
District of Columbia	3,777,249	2,427,422	1,068,821	7,273,492	
Prince George's	1,260,721	753,750	327,688	2,342,159	
Metropolitan Area	22,033,332	10,392,424	2,477,175	34,902,931	

Office Space Inventory by Jurisdiction and Class (sq.ft.)

Jurisdiction	Class A	Class B	Class C	Total
Loudon	5,795,440	3,312,086	529,239	9,636,765
Fairfax	66,618,154	28,063,783	3,539,132	98,221,069
Frederick	2,083,049	1,652,926	409,152	4,145,127
Alexandria/Arlington	24,416,653	17,676,684	6,990,125	49,083,462
Montgomery	31,851,231	22,199,635	6,595,059	60,645,925
District of Columbia	60,625,693	41,586,203	12,351,550	114,563,446
Prince George's	9,881,825	7,784,349	3,318,717	20,984,891
Metropolitan Area	201,272,045	122,275,666	33,732,974	357,280,685

Share of Office Space Inventory by Jurisdiction and Class

Jurisdiction	Class A	Class B	Class C	Total
Loudon	60.1%	34.4%	5.5%	100.0%
Fairfax	67.8%	28.6%	3.6%	100.0%
Frederick	50.3%	39.9%	9.9%	100.0%
Alexandria/Arlington	49.7%	36.0%	14.2%	100.0%
Montgomery	52.5%	36.6%	10.9%	100.0%
District of Columbia	52.9%	36.3%	10.8%	100.0%
Prince George's	47.1%	37.1%	15.8%	100.0%
Metropolitan Area	56.3%	34.2%	9.4%	100.0%

Office Space inventory includes leasable and owner-occupied space. Totals exclude non-classified space. Note:

Vacant means "direct vacant" and does not include sublease space.

Source:

Montgomery County Department of Planning, Research and Technology Center Data compiled from Realty Information Group commercial space data file, 12/16/03